

Health System Acquisition of Rural Hospitals: Do's and Don'ts

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The coronavirus has not been kind to rural hospitals.¹ Although most rural hospitals have not been oversubscribed with COVID patients, the cessation of elective procedures inflicted serious financial harm on rural facilities. From an operational perspective, independent rural hospital CEOs looked on with envy as their health system colleagues were able to acquire and share personal protective equipment, draw upon specialized clinical and medical talent, and leverage important political and government connections. Across the country, there were many examples of systemness at its best.

Pre-pandemic, several rural hospitals established independence as an overarching goal. Today, there is a new perspective shared by some rural hospital CEOs and boards. Combining current financial pressures with real-time examples of system support yields potential new interest among rural hospitals in fully integrating with a larger health system.

Even with an ongoing pandemic, a lot of health systems are

1 Adrian Diaz, Karan R. Chhabra, and John W. Scott, "The COVID-19 Pandemic and Rural Hospitals—Adding Insult to Injury," *Health Affairs Blog*, May 3, 2020.

Key Board Takeaways: Do's and Don'ts

Don't:

- Approach a rural hospital via cold call
- Overlook the local physicians
- Conduct key meetings by teleconference/videoconference
- Skip a face-to-face introduction of the health system CEO
- Misunderstand the significance of operational changes at the local level

Do:

- Work with the system board to develop the must-haves for rural transactions
- Invest time in building rural relationships
- Explore local health needs and service gaps
- Consider a short-term management contract prior to full-asset acquisition
- Focus on strengthening local medical services

well-positioned to advance their growth strategies. Significant opportunity remains for health systems interested in adding rural healthcare assets to their integrated networks.

There are many well-documented affiliation structures for systems and rural hospitals.² The focus of this article is on the acquisition

2 Jordan Shields and Rex Burgdorfer, "Special Section: The Expanding Range of Strategic Alternatives Available in Hospital System Mergers and Acquisitions," *BoardRoom Press*, The Governance Institute, August 2014; Onyinye Oyeka et al., "The Rural Hospital and Health System Affiliation Landscape—A Brief Review," *The Rural Policy Research Institute*, November 2018.

scenario. Without an appropriate level of advance planning at the board level, a system's well-intended acquisition approach may miss the mark entirely. To successfully engage with rural hospitals, health systems must thoughtfully contemplate many questions prior to jumping into rural acquisition mode.

Advance Work

Health system boards should seriously consider the question of whether movement into rural health aligns with their organization's mission and vision. If the answer is "yes," then leadership must examine the depth of organizational commitment available for rural healthcare. This includes executive time, capital

and operating funding for rural acquisitions, and dedication of additional rural-specific resources. Advance research into the resources needed to be successful in operational ownership in the rural space will allow systems to venture into the rural territory with eyes wide open.

Bringing a rural hospital into a fully integrated large health system requires a balance of systemness priorities amidst the local focus of a rural entity. Prior to beginning conversations with a rural hospital about potential acquisition, the board and system leadership should together undergo advance introspection about the functions and decisions that will be centralized at the system level. (See sidebar “Centralized or Local?”) Health systems must scrutinize economies of scale versus the constant tug of local priorities. This list of systematized functions becomes the “must-haves” as a health system begins to consider acquisition of rural partners. At the appropriate time (which is not the first meeting), the health system should share this list with the prospective rural hospital partner. In discussing the list of anticipated consolidated functions, the health system needs to explain the why underlying each item.

Before embarking on a rural acquisition strategy, the health system board should also discuss acquisition circumstances it wishes to avoid. For example, it may be obvious to the health system that rural acute care services will not survive long term, even with a system affiliation. Or perhaps the health system determines that major service reductions (such as obstetrics) will be needed to maintain the rural hospital. Is the health system willing to jump into the crossfire and/or risk its reputation in these difficult

situations? The health system board should thoughtfully consider the scenarios it will *not* entertain for system affiliation.

The health system board should also determine its policy with respect to capital investment in rural facilities. Rural facilities often need major capital for deferred maintenance and to update aging facilities. The health system board will want to consider establishing guidelines about rural hospital capital expenditures.

The Rural Investment

For best success, health systems should be sincerely committed to improving the health of rural populations and communities. This implies ongoing health system dedication to building relationships with rural healthcare organizations and their leaders to best understand local challenges and priorities. With time and energy dedicated to relationship building, the yield will be informed opportunities for the health system. A rural organization will be more open to discussion when the health system has demonstrated trust and understanding of local conditions over time.

One method of deciphering an organization’s true operational and financial situation is to offer consulting and/or management services to the rural hospital. Such services should be a business arrangement—not donated and ideally priced at fair market value. Rural hospitals often benefit from assistance with revenue cycle, financial reporting, human resources support, supply chain optimization, and governance matters. As relationships build, the health system is well positioned should the rural hospital demonstrate an interest in being acquired. Although it is always ideal for a rural hospital board and CEO to initiate the discussion, with a track record of trust and credibility, health system leadership can introduce the acquisition topic for mutual exploration.

Transparency Is the Only Option

During acquisition discussions, significant time must be devoted to achieving an understanding by the local board and C-suite leadership about what will change and what will not change post-acquisition. It can be very tempting to gloss over

Centralized or Local?

- Revenue cycle
- Financial reporting and accounting
- Capital/operating budgets
- Audit firm selection/oversight
- Human resources, including compensation and benefits
- Strategic planning
- Supply chain
- Banking relationships
- Fundraising and development
- Information technology/software systems
- Governance
- Medical staff functions, including credentialing
- Quality
- Population health
- Marketing/branding

the integration details in the rush to successfully conclude a transaction. Achieving clear realization of what joining a system truly means on a day-to-day basis to the rural partner is the best antidote to avoid post-transaction remorse. For example, it is common to require the acquired hospital to adopt the health system's centralized software platforms (financial, human resources, clinical) and group purchasing organization. Rural hospitals must understand the implications with respect to centralization of these functions and the potential impact on local jobs and employment.

The role of the rural hospital board and its level of authority must be clearly explained at an early stage. Understanding is usually not achieved in a single conversation. Hosting a joint meeting with directors from a previously acquired hospital and the board of the target rural hospital is an effective technique to achieve true comprehension of life in an integrated health system.

Physician Leadership

Physicians in rural America are most often directly employed by the rural hospital. Systems should not assume that employed rural physicians will

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follow the lead of the local board and C-suite. It is imperative that local medical leadership be deeply engaged in discussions about joining a health system. Health system leadership must seek out direct interaction with the local physicians to respond to questions and concerns. Naturally, physicians will have a personal interest in any changes to their employment conditions, including the structure of system medical leadership. More broadly, the local physicians need to be intimately involved in discussions about how the health system and its resources can help support patient care in the rural region. Health systems must realize that patients will ask the rural physician in either the coffee shop or the exam room, "Is this health system deal good or bad?" The significant influence of local physicians will always be key to a transaction proceeding or not.

The Health System CEO

The system CEO can play a crucial role in relationship building with a rural board. Even in a pandemic

environment, it is still a face-to-face world—especially in rural America. As it grapples with a decision to permanently affiliate with a health system, a rural board will wish to meet the system CEO personally. Large health systems will generally delegate meetings of this nature to another member of the system executive team. Such a meeting should be held at an appropriate stage of the process. Face-to-face interaction is imperative in continuing to build trust and mutual understanding.

Final Thoughts

Expanding a health system's network into rural America can be a win-win for all parties. The health system benefits from expanding its network and population health initiatives. The rural hospital benefits from access to specialized resources and talent. The best chance for mutual success will come from a health system's advance planning and awareness of its own needs matched with a deep understanding and respect for the challenges of the rural environment.

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